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Exhibit A

Humility, Institutional Constraints and Economic Rigor: Limiting the FTC's Discretion

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Introduction

In 1914, Congress gave the FTC sweeping jurisdiction and broad powers to enforce flexible rules, to ensure that it would have the ability to serve as the regulator of trade and business that Congress intended it be. Much, perhaps even the great majority, of what the FTC does is uncontroversial and is widely supported, even by critics of the regulatory state.

However, both Congress and the courts have expressed concern about how the FTC has used its considerable discretion in some areas. Now, as the agency approaches its 100th anniversary, the FTC, courts, and Congress face a series of decisions about how to apply or constrain that discretion. These questions will become especially pressing as the FTC uses its authority in new ways, expands its authority into new areas, or gains new authority from Congress (such as over data security or privacy).

The FTC oversees nearly every company in America. It polices competition by enforcing the antitrust laws. It tries to protect consumers by punishing deception and practices it deems "unfair." It's the general enforcer of corporate promises made in privacy policies and codes of conduct generated by industry or multistakeholder processes. It's the de facto regulator of the media, from traditional advertising to Internet search and social networks. It handles novel problems of privacy, data security, online child protection, and patent claims, among others. Even net neutrality may soon wind up in the FTC's jurisdiction.

Federal *Technology* Commission

But perhaps most importantly, the Federal Trade Commission has become, for better or worse, the Federal *Technology* Commission. Technology creates a special problem for regulators.

Inherent limitations on anyone's knowledge about the future nature of technology, business and social norms caution skepticism as regulators attempt to predict whether any given business conduct will, on net, improve or harm consumer welfare. In fact, a host of factors suggests that even the best-intentioned regulators may tend toward overconfidence and the erroneous condemnation of novel conduct that benefits consumers in ways that are difficult for regulators to understand.[1] At the same time, business generally succeeds by trial-and-error more than theoretical insights or predictive power,[2] and over-regulation thus risks impairing experimentation, an essential driver of economic progress. As a consequence, doing nothing may sometimes be the best policy for regulators, and limits on regulatory discretion to act can be of enormous importance.[3]

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[1] *See*, *e.g.*, Ronald H. Coase, *Industrial Organization: A Proposal for Research*, *in* ECONOMIC RESEARCH: RETROSPECT AND PROSPECT VOL. 3: POLICY ISSUES AND RESEARCH OPPORTUNITIES IN INDUSTRIAL ORGANIZATION (Victor R. Fuchs, ed. 1972), *available at* http://www.nber.org/chapters/c7618.pdf; Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984); Geoffrey A. Manne & Joshua D. Wright, *Innovation and the Limits of Antitrust*, 6 J. COMPETITION L. & ECON. 153 (2010).

[2] *See* Armen Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).

[3] As Nobel Laureate economist Ronald Coase put it, "direct governmental regulation will not necessarily give

But technology does present unique – or perhaps just especially exigent – challenges for regulators precisely because it tends to create new consumer protection and competition issues, or upset previously settled issues, and because such change tends to occur more rapidly than in some other settings. Regulation abhors a vacuum; technology tends to render existing regulation obsolete, creating such a vacuum. Moreover, technology can give rise to *new* issues, or at least *new-seeming* issues, which can leave regulators looking for novel regulatory tools and justifications for regulation. That is, regulators often feel the need to do *something*, even where it is unclear whether or what regulation is needed.

It is on the cutting edge, new issues that the stress-points in the FTC's general approach become most clearly visible, but these stress-points are by no means unique to the technological setting. Moreover, of particular importance, welfare-enhancing innovation is not just about technological advance, but also organizational, business model and contractual developments, and these important advances can also be threatened by the excessive use of discretion.[4]

But it is in the realm of new technology that many of the FTC's most significant recent cases have arisen and such cases exemplify these concerns. Facing novel data security questions, the agency has pushed the bounds of its authority over unfair and deceptive acts and practices (UDAP)[5] to constrain firms trying to experiment and adapt in the face of developing technology. Similarly, by expressing myriad concerns about business methods and practices in high-tech firms – among them Intel, N-Data, Twitter, Google, Facebook and Apple – and investigating issues ranging from privacy to search engine design to patent enforcement to integrated circuit fabrication, the Commission has pushed the bounds of its Section 5[6] authority, and has indicated its desire to continue expanding the power afforded by that authority. In short, any large (that is, successful and innovative) firm operating in the technology sector, would be prudent to expect that today the FTC is investigating its business practices.

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better results than leaving the problem to be solved by the market or the firm. But equally there is no reason why, on occasion, such governmental administrative regulation should not lead to an improvement in economic efficiency…. There is, of course, a further alternative which is to do nothing about the problem at all." Ronald H. Coase, *The Problem of Social Cost*, 3 J. LAW & ECON. 1, 18 (1960).

[4] *See, e.g.*, Manne & Wright, Innovation, *supra* note 1; ERNEST GELLHORN, & WILLIAM E. KOVACIC, ANALYTICAL APPROACHES AND INSTITUTIONAL PROCESSES FOR IMPLEMENTING COMPETITION POLICY REFORMS BY THE FEDERAL TRADE COMMISSION (Dec. 1995), *available at* http://www.ftc.gov/opp/global/gmu_1.shtm.

[5] The FTC is empowered to police, among other things, "unfair or deceptive acts or practices." 15 U.S.C. § 45(a)(4)(A).

[6] Federal Trade Commission Act, 38 Stat. 719 (codified at 15 U.S.C. §45).

The FTC must always weigh the costs of intervention (and the costs of getting it wrong) against the costs of doing nothing. But what, and who, will limit the discretion of a majority of FTC Commissioners in assessing these trade-offs? It is the age-old question: *Who will watch the watchers?* In technology the question becomes, how should the FTC regulate technology? What's the right mix of the certainty businesses need and the flexibility technological progress demands?

One thing is certain – a top-down, administrative regulatory model of regulation is ill-suited for technology. The epitome of the traditional regulatory model is the FTC's chief rival: the FCC. The 1996 Telecom Act runs nearly 47,000 words — 65 times longer than the Sherman Act, for example. The FCC writes tech-specific regulations before technology has even developed. Virginia Postrel's apt words in *The Future and Its Enemies* describes its mentality best:

> Technocrats are "for the future," but only if someone is in charge of making it turn out according to plan. They greet every new idea with a "yes, but," followed by legislation, regulation, and litigation.... By design, technocrats pick winners, establish standards, and impose a single set of values on the future.[7]

Economics at the FTC

The most important, most welfare-enhancing reform the FTC could undertake is to better incorporate sound economic- and evidence-based analysis in both its substantive decisions as well as in its process. While the FTC has a strong tradition of economics in its antitrust decision-making, its record in using economics in other areas is mixed. Meanwhile, a review of some recent decisions at the agency suggests that the Commission is inconsistent in its application of economic principles.

To be sure, the economic tools that the FTC uses have developed over time. Merger law, for example, used to be about counting the number of firms on one's fingers; now we have much more advanced tools that help decision-makers (and economic actors) to identify actual competitive effects, and that better enable the Commission to distinguish between welfare-enhancing conduct and its close, anticompetitive cousins. But still those tools are not crystal balls, and they have their limitations. Essential to the proper application of economic analysis in FTC decision-making is the recognition of these limits and the resistance to the urge to go *beyond* what our tools can reasonably accomplish.

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[7] VIRGINIA POSTREL, THE FUTURE AND ITS ENEMIES (1998).

In what follows I discuss several important aspects of the FTC's process and substantive decision-making, particularly those that bear on its regulation of technology. In doing so, I assess the contribution (or lack thereof) of proper economic analysis to the Commission's decisions and how it has contributed and can better contribute to the Commission's goal of promoting consumer welfare.

When Joshua Wright was sworn in as Commissioner at the FTC in early 2013, he became only the fourth economist to serve in that capacity and the first JD/PhD to do so. Over the course of his first year on the Commission he has remained resolute in his adherence to economic principles as a guide to his decision-making. As a result, his various speeches, statements and dissents present a foil – a steadfast baseline of economic analysis -- against which to assess the Commission's recent work. For Wright,

> economics provides a framework to organize the way I think about issues beyond analyzing the competitive effects in a particular case, including, for example, rulemaking, the various policy issues facing the Commission, and how I weigh evidence relative to the burdens of proof and production. Almost all the decisions I make as a Commissioner are made through the lens of economics and marginal analysis because that is the way I have been taught to think.[8]

In what follows I draw significantly on Commissioner Wright's decision-making (as well as some of that of fellow Commissioner Maureen Ohlhausen) to highlight the role of economics at the FTC.

Competition

For the most part, and generally in competition issues, the FTC's model is an evolutionary, rather than regulatory, one. It builds flexible law that evolves alongside technology. The agency learns from, and adapts to, the ever-changing technological and business environments. The key (besides, obviously, the ability to understand technology) is economics.

And the FTC has generally been at the forefront among the world's competition agencies

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[8] Interview with Joshua Wright, FTC Commissioner, ABA Antitrust Section, Economic Committee Newsletter, Winter 2014, vol. 13, p. 6, *available at* http://www.americanbar.org/content/dam/aba/publications/antitrust_law/at308000_newsletter_2014winter.authcheckdam.pdf.

in incorporating economics into its decisions. At the same time, judicial decisions are generally well-grounded in economics, and this feeds back into the agency's enforcement actions. Antitrust law has become nearly synonymous with antitrust economics: both courts and agencies weigh the perils of both under- and over-enforcement in the face of unavoidable uncertainty about the future.

The incorporation of this approach to competition law by the courts and regulatory agencies began in the late 1970s with the Supreme Court's 1977 *GTE Sylvania* decision[9] and the important influence of Richard Posner's 1976 book, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE,[10] and Robert Bork's 1978, THE ANTITRUST PARADOX. THE ANTITRUST PARADOX made the case that antitrust law should be based on rigorous economic analysis – and that the subject of that analysis should be protecting consumer welfare. Today the FTC (like the DOJ) incorporates economics into its competition-related Guidelines[11] and enforcement decisions and most cases are now decided by courts under a rule of reason standard – a standard under which plaintiffs generally face the burden of demonstrating that conduct harms consumers and courts weigh its likely costs against its benefits.

One of the central themes of the modern era of antitrust can be characterized as "regulatory humility": Regulators should intervene in markets only with great caution. Several reasons urge such caution. First, the regulator's natural inclination – in fact, his very job – is to regulate. This inclination on the regulator's part is compounded by the fact that, as Ronald Coase explained:

> If an economist finds something – a business practice of one sort or another – that he does not understand, he looks for a monopoly explanation. And as in this field we are very ignorant, the number of ununderstandable practices tends to be very large, and the reliance on a monopoly explanation, frequent.[12]

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[9] Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), *available at* https://supreme.justia.com/cases/federal/us/433/36/case.html.

[10] It is interesting to note that with the publication in 2001 of the second edition of Posner's book, he dropped the "An Economic Perspective" from the title in recognition that the economic approach to antitrust law was no longer merely a distinct "approach," but rather that "antitrust law" had become essentially coextensive with "antitrust law and economics."

[11] *See, e.g.*, United States Department of Justice, *Guidelines and Policy Statements* (last accessed Feb. 25, 2014), http://www.justice.gov/atr/public/guidelines/.

[12] Coase, *Industrial Organization*, *supra* note 1.

Second, the greatest pressure for regulatory intervention against a firm often comes from that firm's competitors, which seek to use regulation to benefit themselves (not consumers). Many antitrust practitioners refer to this as "the first rule of antitrust": competitor complaints indicate that the market is, in fact, competitive. Third, even where regulatory intervention may be justified, it is often not clear what intervention is appropriate to the harms, especially in markets characterized by rapid change or innovation. A significant portion of the of the 125-year history of antitrust regulation is a catalog of failure – efforts that too often harmed the very consumers they were meant to protect.[13]

Last, and perhaps most important, market forces often constrain harmful conduct more effectively than regulation. In competitive markets, a firm's competitors will respond to its conduct. In noncompetitive markets, the monopoly profits extracted by the malfeasant firm will attract entry by competitors eager to share in the surplus as well as a response from firms already in the market. Such market responses may not offer a perfect response to harmful conduct. But they need not be perfect to be preferable to regulation – only better than the also-imperfect regulatory alternative.[14] Given the possibility that seemingly harmful conduct may, in fact, not be harmful, the difficulty of remedying harmful conduct, and the possibility that the remedy could actually harm competition and consumers, it is frequently the case that regulatory inaction is preferable to ill-conceived regulation.

Generally, this approach to analyzing competition concerns is called the "error cost" framework. Such a framework seeks to balance the potential harms of false positives (erroneous intervention) and negatives (erroneous restraint) – so-called Type I and Type II errors – against the potential benefits of correct judgments.[15] The error cost approach has come to dominate antitrust over the past 40 years. There is, however, constant pressure for antitrust law to take a more aggressive stance towards potentially harmful conduct. Yet the courts have consistently held antitrust to the more circumspect approach advocated in THE ANTITRUST PARADOX.

Mergers: *Nielsen/Arbitron*

While the economic approach has come to dominate competition law in both the courts and at the agencies, there are important and troubling exceptions in both places. The

[13] An important exception to this is straightforward cartel prosecution. As I use the terms in these remarks, "antitrust regulation" should be understood not to include straightforward cartel prosecution.

[14] *See* Coase, *Problems of Social Cost*, *supra* note 3.

[15] *See, e.g.*, Manne & Wright, *Innovation*, *supra* note 1.

FTC's consent order in the recent Nielsen/Arbitron merger offers a poignant example.

A properly circumspect, economic approach to analyzing the merger would have done many things, and some of them the FTC did. But essential to economic analysis of technology markets is a regulatory humility that recognizes that the *industry itself* is unaware of how its future will unfold, what technologies will disrupt it, what conduct will prove to be beneficial and what will prove to be harmful. Pre-judging the formation of entirely new markets and assuming technology-based market power in these markets is utterly inconsistent with a proper economic approach.

In *Nielsen/Arbitron*, Commissioner Wright wrote a powerful and important dissent[16] from the FTC's 2-1 (Commissioner Ohlhausen was recused from the matter) decision[17] to impose conditions on Nielsen's acquisition of Arbitron. Essential to Wright's dissent is the absence of any actual existing market supporting the Commission's challenge:

> Nielsen and Arbitron do not currently compete in the sale of national syndicated cross-platform audience measurement services. In fact, there is no commercially available national syndicated cross-platform audience measurement service today. The Commission thus challenges the proposed transaction based upon what must be acknowledged as a novel theory—that is, that the merger will substantially lessen competition in a market that does not today exist.
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> * * *
>
> [W]e...do not know how the market will evolve, what other potential competitors might exist, and whether and to what extent these competitors might impose competitive constraints upon the parties
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> * * *
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> To be clear, I do not base my disagreement with the Commission today on the possibility that the potential efficiencies arising from the transaction would offset any anticompetitive effect. As discussed above, I find no reason to believe the transaction is likely to substantially lessen competition

[16] In the Matter of Nielson Holdings N.V. and Arbitron, Inc. (Sep. 20, 2013), http://www.ftc.gov/os/caselist/1310058/130920nielsenarbitron-jdwstmt.pdf (Commissioner Wright, dissenting) [hereinafter "*Nielsen* Dissent"].

[17] Complaint & Consent, In the Matter of Nielson Holdings N.V. and Arbitron, Inc. (Jan. 24, 2014), http://www.ftc.gov/os/caselist/1310058/index.shtm.

> because the evidence does not support the conclusion that it is likely to generate anticompetitive effects in the alleged relevant market.[18]

The theory put forward by the Commission is the kind of speculative theory that seriously threatens innovation. Regulators are singularly ill-positioned to predict the course of technological evolution — that's why they're not also billionaire innovators. To impose antitrust-based constraints on economic activity *that hasn't yet been contemplated* is directly at odds with a sensible, evidence-based approach to enforcement. It is also of a piece with the technocratic mindset Postrel criticizes (and which, it should be again noted, is not the norm for the FTC):

> For technocrats, a kaleidoscope of trial-and-error innovation is not enough; decentralized experiments lack coherence. "Today, we have an opportunity to shape technology," wrote [Newt] Gingrich in classic technocratic style. His message was that computer technology is too important to be left to hackers, hobbyists, entrepreneurs, venture capitalists, and computer buyers. "We" must shape it into a "coherent picture." That is the technocratic notion of progress: Decide on the one best way, make a plan, and stick to it.[19]

It should go without saying that this is the antithesis of the environment most conducive to economic advancement. Whatever antitrust's role in regulating technology markets, it must be evidence-based, grounded in economics and aware of its own limitations.

The economic problems with such conduct are considerable, as Commissioner Wright notes:

> A future market case, such as the one alleged by the Commission today, presents a number of unique challenges not confronted in a typical merger review or even in "actual potential competition" cases. For instance, it is inherently more difficult in future market cases to define properly the relevant product market, to identify likely buyers and sellers, to estimate cross-elasticities of demand or understand on a more qualitative level potential product substitutability, and to ascertain the set of potential entrants and their likely incentives. Although all merger review necessarily is forward looking, it is an exceedingly difficult task to predict the competitive effects of a transaction where there is insufficient evidence to reliably

[18] Wright, *Nielsen* Dissent, *supra* note 16, at 5-6.

[19] VIRGINIA POSTREL, *supra* note 7.

> answer these basic questions upon which proper merger analysis is based.
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> * * *
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> When the Commission's antitrust analysis comes unmoored from such fact-based inquiry, tethered tightly to robust economic theory, there is a more significant risk that non-economic considerations, intuition, and policy preferences influence the outcome of cases.[20]

As Wright notes, facts are essential, but they are not enough. Particularly when predicting future effects, proper, restrained application of *economic rigor* to the facts is essential. And, as noted above, this entails a recognition of the limits of the regulator's (or anyone's) ability not only to *describe* the future, but to understand its competitive significance.

Thus, compare Commissioner's Wrights words about *Nielsen* with those of Deborah Feinstein, the FTC's current Director of the Bureau of Competition:

> The Commission based its decision not on crystal-ball gazing about what might happen, but on evidence from the merging firms about what they were doing and from customers about their expectations of those development plans. From this fact-based analysis, the Commission concluded that each company could be considered a likely future entrant, and that the elimination of the future offering of one would likely result in a lessening of competition.[21]

Instead of requiring rigorous economic analysis of the facts, for Feinstein the FTC fulfilled its mission in *Nielsen* by considering the "facts" alone (not *economic evidence*, but rather unreliable customer statements and expressions of intent by the parties) and then, at best, casually applying to them the simplistic, outdated structural presumption – the conclusion that increased concentration would lead inexorably to anticompetitive harm. Unfortunately, this mode of analysis underestimates the fragility of factual predictions about the future and elevates the resulting presumed descriptive clarity when it should be emphatically questioning it with more, not less, rigorous economic analysis.

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[20] Wright, *Nielsen* Dissent, *supra* note 16, at 2, 3.

[21] Deborah L. Feinstein, *The Forward-Looking Nature of Merger Analysis*, Speech given at Advanced Antitrust U.S. (2014), *available at* http://www.ftc.gov/system/files/documents/public_statements/forward-looking-nature-merger-analysis/140206mergeranalysis-dlf.pdf.

The Use of "Hot Docs" and Intent Evidence

While the FTC's antitrust cases and Guidelines have generally embraced sensible economic reasoning and been built largely on the basis of rigorous economic evidence, its record, even in recent years, is far from perfect, as its *Nielsen/Arbitron* consent order demonstrates. Instead, the FTC has often based its competition enforcement decisions not on economic evidence pointing to harmful outcomes, but on "hot docs" that purport to evince nefarious motives for challenged conduct – but that do not necessarily shed any light on actual competitive effects.

> This approach has a "the light's better over here" feel to it. It is undoubtedly easier to "discover" anticompetitive behavior and relevant markets by inferences from business language than it is to deduce it from rigorous economic analysis. Although it is not clear that this type of business rhetoric bears much relationship to economic reality, regulators and courts (to say nothing of juries) are moved by it nonetheless.[22]

Recently, the response from some former Commissioners to the DOJ's Section 2 Report,[23] as well as a series of speeches by former Commissioner Rosch,[24] indicate an alarming willingness to challenge economic evidence and economic analysis for the sake of winning cases. To the extent that, as a descriptive matter, economic evidence doesn't help win cases, the fault (if there is one) lies with the courts or with particular judges, not the Commission.

By contrast, however, where the Commission (or its Commissioners) *itself* embraces a diminished role for economic evidence, we should be concerned. The Bureau of Economics and other Commission staff provide economic, analytical inputs to the agency that should

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[22] Geoffrey A. Manne & E. Marcellus Williamson, *Hot Docs vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 ARIZ. L. REV. 609 (2005).

[23] Statement of Commissioners Harbour, Leibowitz and Rosch on the Issuance of the Section 2 Report by the Department of Justice (Aug. 9, 2008), http://www.ftc.gov/sites/default/files/attachments/press-releases/ftc-commissioners-react-department-justice-report-competition-monopoly-single-firm-conduct-under/080908section2stmt.pdf.

[24] J. Thomas Rosch, *Litigating Merger Challenges; Lessons Learned*, based on remarks given at the Bates White Fifth Annual Antitrust Conference (Jun. 2, 2008), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/litigating-merger-challenges-lessons-learned/080602litigatingmerger.pdf; J. Thomas Rosch, *Reactions on Procedure at the FTC*, remarks given at ABA Antitrust Masters Course IV (Sept. 25, 2008), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/reflections-procedure-federal-trade-commission/080925roschreflections.pdf.

be deemed essential to making the right decision at the enforcement stage. The notion that *this* evidence should be disregarded is troubling.

As it happens, and as I've written about at length elsewhere, the non-economic evidence that apparently convinces trial judges can be harmful, suggesting liability where the protection of consumer welfare demands permissiveness.[25] One of the important lessons of economics in antitrust is that economic tools are uniquely capable of distinguishing competitive from anticompetitive conduct — the perennial challenge of non-cartel antitrust enforcement and adjudication. There is no basis for the argument that, at the Commission level, we should be using less of our best tool because it is complicated and can involve Greek letters. As Commissioner Wright recently noted,

> In litigation, when you are in front of a judge, you have competing expert witness reports, and you have some hot docs. As a litigation strategy, it may be tempting to emphasize the documents because they are easier for the judge to understand than the standard errors of a regression. If that is true, then documents would tend to be over-emphasized in litigation.[26]

No doubt economists could be better at making their work accessible to a lay audience, including FTC Commissioners. But Commissioners at an expert antitrust agency have the responsibility and obligation to use all of the tools at their disposal not just to win cases, but first and foremost to understand the underlying economic issues that shed light on whether challenged conduct will harm or help consumers in practice. For instance, where economic analysis demonstrates that there is bad case law on the books that hasn't been overturned, there is a strong argument that, as an agency that provides a public good, the FTC should heed its economic wisdom and refrain from using such case law to win cases. The agency should also be concerned about making sure that competition law and policy develop correctly and in accordance with economic prescriptions, not just about winning cases at all costs.

But much non-economic evidence is counter-productive in this enterprise, tending to obscure rather than illuminate the competitive significance of ambiguous conduct:

> The problem is that these documents are easily misunderstood, and thus

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[25] *See* Manne & Williamson, *supra* note 22.

[26] Interview with Joshua Wright, FTC Commissioner, ABA Antitrust Section, Economic Committee Newsletter, Winter 2014, vol. 13, p. 6, *available at* http://www.americanbar.org/content/dam/aba/publications/antitrust_law/at308000_newsletter_2014winter.authcheckdam.pdf.

while the economic significance of such documents is often quite limited, their persuasive value is quite substantial. As one prominent accounting scholar notes, business documents and public filings containing accounting data "are useful for internal control, but are not designed or often useful for the measurements demanded by economists and lawyers."

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To be sure, business documents can be appropriately useful to regulators in certain areas of inquiry. Business documents may be useful in providing data for economic analysis, and business documents also serve to provide a basic picture of the industry under scrutiny.

On the other hand, some uses of these documents are simply inappropriate; in many cases, antitrust regulators and plaintiffs attribute unjustified economic and legal significance to the language of corporate managers. The consequence is that regulators and courts are writing out the economic underpinning of the antitrust laws and substituting rhetoric and unreliable accounting instead. This may lead to misguided enforcement that chills the competitive activity that antitrust is intended to foster.[27]

Intent evidence is similarly problematic:

[U]nder some circumstances it makes sense for decision-makers to infer conduct from belief or intent.... But this inference is permissible only if there is truth to the underlying premise that an actor's intentions do, in fact, correlate with his actions. With respect to behavior subject to antitrust regulation, this is not necessarily the case. There is a significant distinction between the reliability of evidence used to demonstrate that an actor engaged in specific, intended conduct, and evidence used to demonstrate that an actor's conduct had a particular, economic, and legal effect.

* * *

The core problem is not that courts are unable to discern anticompetitive intent where it is present, nor even that they mistake procompetitive for anticompetitive intent (although these are problems, to be sure). Rather the

[27] Manne & Williamson, *supra* note 22, at 612 (quoting George J. Benston, *Accounting Numbers and Economic Values*, 27 ANTITRUST BULL. 161, 162 (1982)).

> problem is the fundamental and inextricable disconnect between intent and effect in complex economic systems.[28]

Or as one court put it:

> [A]n admitted intention to limit competition will not make illegal conduct that we know to be pro-competitive or otherwise immune from antitrust control. And, while "smoking gun" evidence of an intent to restrain competition remains relevant to the court's task of discerning the competitive consequences of a defendant's actions, "ambiguous indications of intent do not help us 'predict [the] consequences [of a defendant's acts]'" and are therefore of no value to a court analyzing a restraint under the rule of reason, where the court's ultimate role is to determine the net effects of those acts. Under such circumstances, we apply the rule of reason without engaging in the relatively fruitless inquiry into a defendant's intent.[29]

And as the court in *Microsoft* noted:

> [O]ur focus is upon the effect of that conduct, not upon the intent behind it. Evidence of the intent behind the conduct of a monopolist is relevant only to the extent it helps us understand the likely effect of the monopolist's conduct.[30]

Unfortunately, the Commission has shown a willingness to defer to intent evidence to make out (or define) anticompetitive conduct. In its statement closing its investigation into Google's search practices,[31] while the agency properly refrained from bringing a case, it nevertheless erred in some of its reasoning in getting there: Rather than focusing solely on Google's conduct and its anticompetitive effect, the FTC's statement also paid particular attention to Google's intent. Critics had contended that Google had engaged in conduct with exclusionary effect in search. But in the Commission's final ruling, there was no discussion of whether search bias (demoting a competitor in organic search results) actually constituted a refusal to deal. Rather, the discussion focused (appropriately) on effects and procompetitive justification, and (inappropriately) on Google's intent — but not

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[28] *Id*. at 647-49.

[29] California Dental Ass'n v. FTC, 224 F.3d 942, 948 (9th Cir. 2000).

[30] United States v. Microsoft, 253 F.3d 34, 58-59 (D.C. Cir. 2001) (en banc).

[31] Federal Trade Commission, *Statement Regarding Google's Search Practices, In the Matter of Google Inc*., at 3 (Jan. 3, 2013), *available at* http://www.ftc.gov/os/2013/01/130103googlesearchstmtofcomm.pdf.

on the nature of the conduct itself.

The consideration of Google's intent in this context is inappropriate. While it may have been appropriate to look at in determining *what* Google was doing, and in identifying possible procompetitive justifications, the intent behind Google's practices is irrelevant. What matters is their actual effects on consumers.

The *McWane* Case

Meanwhile, the FTC's staff recently fell prey to the lure of non-economic evidence in bringing its recent administrative collusion and exclusion case against McWane, a manufacturer of iron pipe fittings. Fortunately, the ALJ threw out a significant portion of the case on the grounds that the Complaint Counsel did not make out an economically rigorous case, noting that its evidence was "weak," "unsupported speculation" and that its "daisy chain of assumptions fails to support or justify an evidentiary inference of any unlawful agreement involving McWane."[32]

On the other hand, while the Commissioners upheld the ALJ's ruling against the Commission on the conspiracy counts,[33] a majority of the Commissioners (with Commissioner Wright dissenting) missed the full economic significance of the evidence at trial and held in favor of the Commission's Complaint Counsel on the exclusion count — largely because one of McWane's competitors "made self-serving assertions that it would have had more business but for the defendant's action and would have had lower per-unit costs if it had more business."[34]

In fact, Complaint Counsel relied entirely on business documents to make its case — and a majority of the Commission accepted its arguments. The Commission's expert report on the monopolization count was little more than an economist reciting the theoretical conditions in the economic literature for exclusive dealing to harm competition — with no evidence pointing to the actual anticompetitive outcomes necessary to properly make a case. As Commissioner Wright noted in his dissent from this portion of the holding, this

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[32] In the Matter of McWane, Inc., Docket No. 9351, Initial ALJ Decision, at 286, 300, 306-07 (May 8, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/cases/2013/05/130509mcwanechappelldecision.pdf.

[33] *See* In the Matter of McWane Inc., Docket No. 9351, Opinion of the Commission (Feb. 6, 2014), *available at* http://www.ftc.gov/system/files/documents/cases/140206mcwaneopinion.pdf.

[34] Thom Lambert, *Commissioner Wright's McWane Dissent Illuminates the Law and Economics of Exclusive Dealing*, TRUTH ON THE MARKET (Feb. 17, 2014), http://truthonthemarket.com/2014/02/17/commissioner-wrights-mcwane-dissent-illuminates-the-law-and-economics-of-exclusive-dealing/.

lapse had significant effect, essentially rewriting the well-accepted standards required to prove a violation of Section 2 of the Sherman Act:

> [N]either Complaint Counsel nor the Commission provides an analytical link between Complaint Counsel's foreclosure analysis and competitive harm... — that is, evidence consistent with Complaint Counsel's theory and Complaint Counsel and the Commission's assertion that the level of foreclosure was sufficient to cause competitive harm over the time it was in effect. Neither Complaint Counsel nor the Commission makes any attempt to reconcile the absence of actual evidence of anticompetitive effects with the high foreclosure rates they claim are at issue. Because foreclosure rates are relevant only as a proxy for better understanding competitive effects, this failure undermines the Commission's heavy reliance upon inferences drawn from foreclosure rates. By concluding that Complaint Counsel need only demonstrate that [McWane's competitor] was foreclosed from some unspecified amount of distributors as a result of the [McWane's exclusive dealing program], without linking that foreclosure to the preservation of McWane's monopoly power, the Commission in effect holds that harm to a competitor without more is sufficient to establish a violation of Section 2.[35]

As Wright points out in his dissent, if there were evidence of actual harm it would have been readily available to Complaint Counsel because the conduct at issue in the case occurred in the past. Instead, Complaint Counsel (which was authorized by the Commission to pursue the case) made an affirmative choice to forego adducing this economic evidence and to rely instead on "hot" docs rather than "cold" economics. In accepting this evidence a majority of the Commission produced an outcome unsupported by the evidence and in violation of one of the first, cardinal rules of antitrust:

> Because antitrust exists to protect competition, not competitors, an antitrust complainant cannot base a claim of monopolization on the mere fact that its business was injured by the defendant's conduct.... If antitrust is to remain a consumer-focused body of law, claims like [McWane's competitor's] should fail. Hopefully, Commissioner Wright's FTC colleagues will eventually see that point.[36]

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[35] In the Matter of McWane Inc., Docket No. 9351, Dissenting Statement of Commissioner Joshua D. Wright at37 (Feb. 6, 2014), *available at* http://www.ftc.gov/system/files/documents/cases/140206mcwanestatement.pdf.

[36] Lambert, *supra* note 34.

Unfair Methods of Competition and Guidelines

As antitrust law began to shift toward the "rule of reason," the FTC began, in the 1980s, to push the boundaries of its UMC authority beyond the traditional antitrust laws in a trio of cases.[37] However, the FTC's position was roundly rejected by the courts. Advocates for a more expansive approach to antitrust law generally have continued to advocate the view that Section 5 incorporates, but expands beyond, the "antitrust laws," however.[38] Importantly, the room for such expansion exists because the FTC has never limited its discretion to interpret or enforce its UMC authority with Guidelines or other express limiting principles.

Among the agency's activities, the issuing of guidelines, policy statements, advisory letters and the like regarding its own authority are unique in that they tend to *restrain* the scope of the agency's discretion rather than expand it. Other than increased judicial oversight (or legislated jurisdictional limitations), such guidance may be the most effective procedural tool for cabining agency discretion.

Ideally, the agency's guidelines and policy statements would be constituted to accurately reflect agency practice and legal interpretations, offering insight into the agency's decision-making process, the benefits of its expertise and a clear signal of its likely future actions. Because guidelines are not binding,[39] actual enforcement (and regulatory) actions may deviate from their prescriptions. However, guidelines and other policy statements may have important effect on subsequent agency actions. For instance, they may affect a court's subsequent evaluation of an agency action, or provide potential litigants with insights needed to mount an effective judicial challenge. Should the agency act contrary to its published position, this may provide impetus for Congressional scrutiny of the agency. Moreover, deviation from its prior published statements may incur reputational harms of concern to the Commission. And importantly, to the extent that guidelines incorporate well-established economic principles, deviation from them may be readily apparent and subject to criticism from economists and economically savvy practitioners.

Despite (or because of) their imposition of constraints on discretion, some of the FTC's

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[37] *See* E.I. duPont de Nemours & Co. v. FTC, 729 F.2d 128 (2d Cir. 1984); Boise Cascade v. FTC, 637 F.2d 573 (9th Cir. 1980); Official Airline Guides v. FTC, 630 F.2d 920 (2d Cir. 1980).

[38] For an informative discussion on the FTC's UMC authority and Commissioner Wright's call for more guidance from a variety of perspectives, see Truth on the Market Blog Symposium on UMC (Aug. 1-2, 2013), http://truthonthemarket.com/category/umc-symposium/.

[39] DISH Network, LLC v. FCC and United States, No. 13-1182 (DC Cir. Jan. 22, 2014).

guidelines have been enormously successful. The Horizontal Merger Guidelines have historically "provide[d] a flexible, comprehensive, and administrable approach," while still remaining both "broadly applicable and providing certainty to businesses and practitioners."[40] Moreover, they seem, generally, to reflect actual agency practice. That said, it is telling to note that the FTC and DOJ's decision to revise these guidelines in 2010 has been met with criticism. It remains to be seen how they will be embraced by the courts and what lasting effects they will have on merger review.

Unfair Methods of Competition

As in other areas, the Commission is playing with fire in its UMC cases, as well. And here, because the FTC's authority is drawn directly from Section 5, and with vanishingly little in the way of judicial decisions to interpret the statute or cabin the FTC's discretion, the FTC's pursuit of Section 5 as an independent basis to bring competition claims not recognized by the antitrust laws risks upending the analytical discipline provided by economics.

Section 5 enforcement standards in the unfairness context are non-existent. Former Chairman Leibowitz and former Commissioner Rosch, in particular, have, in several places, argued for an expanded use of Section 5, both as a way around judicial limits on the scope of Sherman Act enforcement, as well as as an affirmative tool to enforce the FTC's mandate. As the Commission's statement in the *N-Data* case concluded:

> We recognize that some may criticize the Commission for broadly (but appropriately) applying our unfairness authority to stop the conduct alleged in this Complaint. But the cost of ignoring this particularly pernicious problem is too high. Using our statutory authority to its fullest extent is not only consistent with the Commission's obligations, but also essential to preserving a free and dynamic marketplace.[41]

The problem is that neither the Commission, the courts nor Congress has defined what, exactly, the "fullest extent" of the FTC's statutory authority is. And, as Commissioner Wright noted in his speech introducing his proposed UMC Policy Statement, "[i]n practice…, the scope of the Commission's Section 5 authority today is as broad or as narrow as a

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[40] Timothy J. Muris and Bilal Sayyed, *Three Key Principles for Revising the Horizontal Merger Guidelines*, ANTITRUST SOURCE 3-4 (April 2010), *available at* http://www.law.gmu.edu/assets/files/publications/working_papers/1256ThreeKeyPrinciples.pdf.

[41] In the Matter of Negotiated Data Solutions LLC., Statement of the Commission at 3, *available at* http://www.ftc.gov/os/caselist/0510094/080122statement.pdf.

majority of the commissioners believes that it is."[42] The Commission's claim that it applied its authority "broadly (but appropriately)" in *N-Data* is unsupported and unsupportable. As Commissioner Ohlhausen put it in her dissent in *In re Bosch*,

> I simply do not see any meaningful limiting principles in the enforcement policy laid out in these cases. The Commission statement emphasizes the context here (i.e. standard setting); however, it is not clear why the type of conduct that is targeted here (i.e. a breach of an allegedly implied contract term with no allegation of deception) would not be targeted by the Commission in any other context where the Commission believes consumer harm may result. If the Commission continues on the path begun in *N-Data* and extended here, we will be policing garden variety breach-of-contract and other business disputes between private parties.
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> * * *
>
> It is important that government strive for transparency and predictability. Before invoking Section 5 to address business conduct not already covered by the antitrust laws (other than perhaps invitations to collude), the Commission should fully articulate its views about what constitutes an unfair method of competition, including the general parameters of unfair conduct and where Section 5 overlaps and does not overlap with the antitrust laws, and how the Commission will exercise its enforcement discretion under Section 5. Otherwise, the Commission runs a serious risk of failure in the courts and a possible hostile legislative reaction, both of which have accompanied previous FTC attempts to use Section 5 more expansively.
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> This consent does nothing either to legitimize the creative, yet questionable application of Section 5 to these types of cases or to provide guidance to standard-setting participants or the business community at large as to what does and does not constitute a Section 5 violation. Rather, it raises more questions about what limits the majority of the Commission would place on its expansive use of Section 5 authority.[43]

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[42] Joshua Wright, *Section 5 Recast: Defining the Federal Trade Commission's Unfair Methods of Competition Authority* (Jun. 19, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/section-5-recast-defining-federal-trade-commissions-unfair-methods-competition-authority/130619section5recast.pdf.

[43] In the Matter of Robert Bosch GmbH, FTC File No. 121-0081 (Commissioner Ohlhausen, dissenting),

The FTC has never explained what its "unfair methods of competition" authority covers that antitrust doesn't. Commissioner Wright recently proposed limiting principles, but FTC Chairman Edith Ramirez appears reluctant to relinquish any discretion. Wright's proposed guidance would bring not only an appropriate economic framework to bear on UMC cases — one that mimics the guidance and judicial opinions that govern in Sherman and Clayton Act cases — but would provide a constraint on unfettered agency discretion.[44]

Commissioner Wright's proposed statement on enforcement of Section 5 of the FTC Act against Unfair Methods of Competition attempts to remedy these defects, and, in the process, explains why the Commission's previous, broad applications of the statute are not, in fact, appropriate. His draft statement, along with the policy speech in which he introduced it,[45] present a compelling and comprehensive vision for Section 5 UMC reform at the Commission.

At the outset of his statement Wright invokes the importance of limiting principles:

> In order for enforcement of its unfair methods of competition authority to promote consistently the Commission's mission of protecting competition, the Commission must articulate a clear framework for its application.[46]

Significantly, in addition to offering important certainty to guide business actions, Wright bases his proposed policy statement on the error cost framework:

> The Commission must formulate a standard that distinguishes between acceptable business practices and business practices that constitute an unfair method of competition in order to provide firms with adequate guidance as to what conduct may be unlawful. Articulating a clear and predictable standard for what constitutes an unfair method of competition is important because the Commission's authority to condemn unfair methods of competition allows it to break new ground and challenge conduct based upon theories not previously enshrined in Sherman Act or Clayton Act

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available at http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-maureen-ohlhausen/121126boschohlhausenstatement.pdf [hereinafter "Ohlhausen Bosch Dissent"], at 3-4.

[44] Joshua Wright, *Proposed Policy Statement Regarding Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act* (Jun. 19, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-joshua-d.wright/130619umcpolicystatement.pdf.

[45] *See* Wright, *Section 5 Recast*, *supra* note 42.

[46] Wright, *Proposed Policy Statement*, *supra* note 44, at 2.

> jurisprudence.

Such restraint is crucial at the FTC. Efforts by the agency's immediate past Chairman and others to expand Section 5 to challenge conduct under novel theories, devoid of economic grounding and without proof of anticompetitive harm (in cases like *Intel*,[47] *N-Data*[48] and *Google*,[49] among others) brought into stark relief the potential risks of an unfettered Section 5.

Particularly given the novelty of circumstances that might come within Section 5's ambit, the error-cost minimizing structure of Commissioner Wright's proposed statement is enormously important. As Wright and I note in a co-authored paper, *Innovation and the Limits of Antitrust*:

> Both product and business innovations involve novel practices, and such practices generally result in monopoly explanations from the economics profession followed by hostility from the courts (though sometimes in reverse order) and then a subsequent, more nuanced economic understanding of the business practice usually recognizing its procompetitive virtues.[50]

And as Wright's statement notes,

> This is particularly true if business conduct is novel or takes place within an emerging or rapidly changing industry, and thus where there is little empirical evidence about the conduct's potential competitive effects.[51]

The high cost and substantial risk of false positives arising from unbounded Section 5 authority counsel strongly in favor of Wright's statement restricting Section 5 to minimize these error costs.

In important ways the real work in Wright's statement is done by the limitation on UMC

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[47] In the Matter of Intel Corp., Docket No. 9341, http://www.ftc.gov/enforcement/cases-proceedings/061-0247/intel-corporation-matter.

[48] In the Matter of Negotiated Data Solutions LLC., FTC File No. 051 0094, http://www.ftc.gov/enforcement/cases-proceedings/051-0094/negotiated-data-solutions-llc-matter.

[49] In the Matter of Motorola Mobility LLC and Google Inc., FTC File No. 1210120, http://www.ftc.gov/enforcement/cases-proceedings/1210120/motorola-mobility-llc-google-inc-matter.

[50] Manne & Wright, *Innovation*, *supra* note 1, at 165.

[51] Wright, *Proposed Policy Statement*, *supra* note 44, at 11.

enforcement in cases where the complained-of practice produces cognizable efficiencies. In his framing it is not a balancing test or a rule of reason. It is a safe harbor for cases where conduct is efficient, regardless of its effect on competition otherwise:

> The Commission therefore creates a clear safe harbor that provides firms with certainty that their conduct can be challenged as an unfair method of competition only in the absence of efficiencies.[52]

Wright's Proposed UMC Statement is the most important and ambitious effort to date to incorporate the error cost framework into FTC antitrust enforcement policy. This aspect of the statement takes seriously the harm that can arise from the agency's discretion, uncertainty over competitive effects (especially in "likely to cause" cases) and the imbalance of power and costs inherent in the FTC's Part III adjudication to tip the scale back toward avoidance of erroneous over-enforcement.

In essence, by removing the threat of Section 5 enforcement where efficiencies are cognizable, Wright's statement avoids the risk of Type I error, prioritizing the possible realization of efficiencies over possible anticompetitive harm with a bright line rule that avoids attempting to balance the one against the other:

> The Commission employs an efficiencies screen to establish a test with clear and predictable results that prevents arbitrary enforcement of the agency's unfair methods of competition authority, to focus the agency's resources on conduct most likely to harm consumers, and to avoid deterring consumer welfare-enhancing business practices.[53]

Fundamentally, as Commissioner Wright explained in his speech,

> Anticompetitive conduct that lacks cognizable efficiencies is the most likely to harm consumers because it is without any redeeming consumer benefits. The efficiency screen also works to ensure that welfare-enhancing conduct is not inadvertently deterred.... The Supreme Court has long recognized that erroneous condemnation of procompetitive conduct significantly reduces consumer welfare by deterring investment in efficiency-enhancing business practices. To avoid deterring consumer welfare-enhancing conduct, my proposed Policy Statement limits the use of Section 5 to conduct that lacks

[52] *Id*. at 10.

[53] *Id*. at 9.

> cognizable efficiencies.[54]

Wright's statement encapsulates the sort of economic principles — both in substance and in regulatory form — that would bring the sound economic grounding of antitrust law and economics to Section 5, benefiting consumers as well as commerce generally:

> This Policy Statement benefits both consumers and the business community by relying on modern economics and antitrust jurisprudence to strengthen the agency's ability to target anticompetitive conduct and provide clear guidance about the contours of the Commission's Section 5 authority.[55]

Importantly, this is as much about preserving the FTC itself as it is about good economics:

> In undertaking this task, I think it is important to recall why the Commission's use of Section 5 has failed to date. In my view, this failure is principally because the Commission has sought to do too much with Section 5, and in so doing, called into serious question whether it has any limits whatsoever. In order to save Section 5, and to fulfill the vision Congress had for this important statute, the Commission must recast its unfair methods of competition authority with an eye toward regulatory humility in order to effectively target plainly anticompetitive conduct..... I believe that doing anything less would betray our obligation as responsible stewards of the Commission and its competition mission, and may ultimately result in the Commission having its Section 5 authority defined for it by the courts, or worse, having that authority completely revoked by Congress.[56]

This means circumscribing the FTC's Section 5 authority to limit enforcement to cases where the Commission shows both actual harm to competition and the absence of cognizable efficiencies.

Commissioner Wright's statement does not represent a restriction of antitrust enforcement authority unless you take as your starting point the agency's recent largely unsupported and expansive interpretation of Section 5—a version of Section 5 that arguably was never intended to exist. Wright's statement is, rather, a bulwark against unprincipled regulatory expansion: a sensible grounding of a statute with a checkered past and a penchant for

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[54] *Id*. at 10.

[55] *Id*. at 2.

[56] Wright, *Section 5 Recast*, *supra* note 42, at 15.

mischief.

Moreover, Wright's statement doesn't mean that the FTC can't bring cases in which the anticompetitive harm outweighs the efficiency benefits. As always, those cases can be, should be and are brought under the traditional antitrust laws.

Former Chairman Leibowitz and former Commissioner Rosch, in defending the use and expansion of Section 5, argued in *Intel* that it was necessary to circumvent judicial limitations on the enforcement of Section 2 aimed only at *private* plaintiffs.[57] According to Leibowitz, the Court's economically rigorous, error-cost jurisprudence in cases like *linkLine*,[58] *Trinko*,[59] *Leegin*,[60] *Twombly*,[61] and *Brook Group*[62] were aimed at private plaintiffs, not agency actions:

> But I also believe that the result, at least in the aggregate, is that some anticompetitive behavior is not being stopped—in part because the FTC and DOJ are saddled with court-based restrictions that are designed to circumscribe private litigation. Simply put, consumers can still suffer plenty of harm for reasons not encompassed by the Sherman Act as it is currently enforced in the federal courts.[63]

The claim is meritless.[64] But it helps to make clear what the problem with current Section 5 standards are: There are no standards, only post-hoc rationalizations to justify pursuing Section 2 cases without the cumbersome baggage of its jurisprudential limits.

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[57] Statement of Chairman Leibowitz and Commissioner Rosch, In the Matter of Intel Corporation, Docket No. 9341, http://www.ftc.gov/sites/default/files/documents/cases/091216intelchairstatement.pdf.

[58] Pacific Bell Telephone Co. v. linkLine Communications, Inc., 555 U.S. 438 (2009).

[59] Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

[60] Leegin Creative Leather Products, Inc. v. PSKS, Inc. 127 S. Ct. 2705 (2007).

[61] Bell Atlantic Corp. v. Twombly, 127 S. Ct. 1955 (2007).

[62] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

[63] Jon Leibowitz, *"Tales from the Crypt" Episodes '08 and '09: The Return of Section 5 ("Unfair Methods of Competition in Commerce are Hereby Declared Unlawful")*, remarks at Section 5 Workshop (Oct. 17, 2008), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/tales-crypt.episodes-08-and-09-return-section-5-unfair-methods-competition-commerce-are-hereby-declared-unlawful/081017section5.pdf.

[64] *See, e.g.*, Geoffrey Manne, *The Case Against the Section 5 Case Against Intel Redux*, TRUTH ON THE MARKET (Jan. 8, 2010), http://truthonthemarket.com/2010/01/08/the-case-against-the-section-5-case-against-intel-redux-cross-posted/.

The recent Supreme Court cases mentioned above are only the most recent examples of a decades-long jurisprudential trend incorporating modern economic thinking into antitrust law and recognizing the error-cost tradeoff.[65] These cases have served to remove certain conduct (at least without appropriate evidence and analysis) from the reach of Section 2 in a measured, accretive fashion over the last 40 years or so. They have by no means made antitrust irrelevant, and the agencies and private plaintiffs alike bring and win cases all the time—and this doesn't even measure the conduct that is deterred by the threat of enforcement.

The limits on Section 5 suggested by Commissioner Wright's statement are marginal limits on the scope of antitrust *beyond* the Sherman Act, Clayton Act and other statutes and are consistent with the generally accepted standards of Section 5.

And with Chairman Ramirez' recent speech at the 2014 George Mason Law Review Symposium on Antitrust Law, even she has essentially endorsed a "rule of reason" approach to Section 5 that requires a showing of harm to competition:

> Our most recent Section 5 cases show that the Commission will condemn conduct only where, as with invitations to collude, the likely competitive harm outweighs the cognizable efficiencies. This is the same standard we apply everyday in our investigations.[66]

While perhaps this admission doesn't go far enough, now all four currently sitting Commissioners have at least partially endorsed the idea of enumerated standards for Section 5 built on a fundamentally "rule of reason" approach. There is hope.

Patents

Perhaps nothing the FTC does more directly implicates technology and innovation than its treatment of intellectual property. Writing about "Antitrust in the New Economy," Judge Posner noted that the "principal output of these industries… is intellectual property."[67] But

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[65] *See* Leah Brannon & Douglas H. Ginsburg, *Antitrust Decisions of the U.S. Supreme Court 1967 to 2007*, 3 COMPETITION POL'Y INT'L 1 (2007), available at https://www.competitionpolicyinternational.com/antitrust-decisions-of-the-us-supreme-court-1967-to-2007.

[66] Edith Ramirez, Keynote, 17th Annual George Mason Law Review Symposium on Antitrust Law: "The FTC: 100 Years of Antitrust and Competition Policy" (2014), *available at* http://vimeo.com/86788312. *See also* Erica Teichert, *FTC Commissioners Spar Over Section 5 Guidance Boundaries*, LAW360 (Feb. 13, 2014), http://www.law360.com/articles/509894/ftc-commissioners-spar-over-section-5-guidance-boundaries.

[67] Richard A. Posner, *Antitrust in the New Economy*, 68 ANTITRUST L.J. 925, 927 (2001).

as far as antitrust economics has progressed generally, it still lacks a solid understanding of the relationship among investment in R&D, market structure, price, quality, speed of innovation and welfare effects.[68] The risk of Type I error is thus particularly high, and its potential cost higher still.[69]

Nonetheless, basic economics suggests that, in unknown degrees, the production, distribution and enforcement of intellectual property will lead to standardization (coordination among competitors), the need for interoperability (and thus a greater opportunity for anticompetitive foreclosure), economies of scale (high levels of concentration), and the presence of network effects, all of which may contribute to an increased likelihood of monopolization.[70] At the same time, many question the validity of many patents and the reliability of the patent approval process, and note the potential for "greenmail." These critics have encouraged the FTC to use its UMC authority against companies asserting legally questionable or standard-essential patents (SEPs) in certain contexts.

Against this backdrop, the FTC has in recent years stepped up its enforcement around patents. Recent (and controversial) Section 5 cases against Intel,[71] Rambus,[72] Google[73] and Bosch,[74] for example, have turned on issues surrounding those firms' enforcement of SEPs. The Commission is currently conducting a 6(b) investigation into patent assertion entities, and the FTC has pursued a vigorous and lengthy war on pharmaceutical industry reverse payment settlements.

The question of the appropriate application of UMC to patent issues, particularly to police the enforcement of SEPs through the threat of injunctions and the breach of FRAND requirements by certain patent holders, is a controversial one. But here as elsewhere the

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[68] One important, recent effort to overcome this lack is Daniel F. Spulber, *How Do Competitive Pressures Affect Incentives to Innovate when there is a Market for Inventions?*, 121 J. POL. ECON. 1007 (2013).

[69] Manne & Wright, *Innovation and Limits*, *supra* note 1, at 170.

[70] *Id*.

[71] In the Matter of Intel Corp., Docket No. 9341, http://www.ftc.gov/enforcement/cases-proceedings/061-0247/intel-corporation-matter.

[72] In the Matter of Rambus Inc., Docket No. 9302, http://www.ftc.gov/enforcement/cases-proceedings/110017/rambus-inc-matter.

[73] In the Matter of Motorola Mobility LLC and Google Inc., FTC File No. 1210120, http://www.ftc.gov/enforcement/cases-proceedings/1210120/motorola-mobility-llc-google-inc-matter.

[74] In the Matter of Robert Bosch GmbH, FTC File No. 121-0081, http://www.ftc.gov/enforcement/cases-proceedings/1210081/bosch-robert-bosch-gmbh.

core of the controversy may rest in the appropriate exercise of discretion generally rather than as applied to patents in particular. As Commissioner Ohlhausen wrote in dissenting from the Commission's action in Bosch:

> I simply do not see any meaningful limiting principles in the enforcement policy laid out in these cases. The Commission statement emphasizes the context here (i.e. standard setting); however, it is not clear why the type of conduct that is targeted here (i.e. a breach of an allegedly implied contract term with no allegation of deception) would not be targeted by the Commission in any other context where the Commission believes consumer harm may result.[75]

Applying Section 5 to FRAND-encumbered SEPs, as I have discussed at length elsewhere, is problematic.[76] As Kobayashi and Wright note in discussing the *N-Data* case,

> [T]he truth is that there was little chance the FTC could have prevailed under the more rigorous Section 2 standard that anchors the liability rule to a demanding standard requiring proof of both exclusionary conduct and competitive harm. One must either accept the proposition that the FTC sought Section 5 liability precisely because there was no evidence of consumer harm or that the FTC believed there was evidence of consumer harm but elected to file the Complaint based only upon the Section 5 theory to encourage an expansive application of that Section, a position several Commissioners joining the Majority Statement have taken in recent years. Neither of these interpretations offers much evidence that N-Data is sound as a matter of prosecutorial discretion or antitrust policy.[77]

None of the FTC's SEP cases has offered anything approaching proof of consumer harm, and this is where any sensible, economically grounded limiting principles must begin. Moreover, even if they did adduce evidence of harm, the often-ignored problem of reverse hold-up raises precisely the concern about over-enforcement that the "no efficiencies"

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[75] Ohlhausen, Bosch Dissent, supra note 43, at 3.

[76] *See* International Center for Law & Economics Comment Regarding the Proposed Order, In the Matter of Motorola Mobility LLC and Google, Inc., File No.121-0120, *available at* http://laweconcenter.org/images/articles/icle_comment_google_order.pdf.

[77] Bruce Kobayashi & Joshua Wright, *Federalism, Substantive Preemption, And Limits On Antitrust: An Application To Patent Holdup*, 5 J. COMPETITION L. & ECON. 469 (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1143602.

prong in Commissioner Wright's UMC Policy Statement (discussed above) is meant to address. Hold-up may raise consumer prices (although the FTC has not presented evidence of this), but reverse hold-up may do as much or more damage.

And, as it happens, true hold-ups are exceedingly rare; even in the literature there are few examples of actual hold-ups (or patent thickets) impeding innovation. Thus, while competition law might offer a potential benefit from preventing those few cases, it is unlikely that such benefit would exceed the serious effects on innovation, standardization and patent licensing that an antitrust-based constraint on patent rights would engender.

The use of injunctions to enforce SEPs strengthens property rights and, in turn, increases innovation investment, the willingness to license generally and the willingness to enter into FRAND commitments in particular – all to the likely benefit of consumer welfare. If the FTC interprets its UMC authority in a way that constrains the ability of patent holders to effectively police their patent rights, then less innovation would be expected–to the detriment of consumers as well as businesses. An unfettered UMC authority will systematically curtail these benefits, quite possibly with only trivial countervailing positive effects.

And, as I have pointed out before, these costs are real.[78] Innovative technology companies are responding to the current SEP enforcement environment exactly as we would expect them to: by avoiding the otherwise-consumer-welfare-enhancing standardization process entirely:

> Because of the current atmosphere, Lukander said, Nokia has stepped back from the standardisation process, electing either not to join certain standard-setting organisations (SSOs) or not to contribute certain technologies to these organisations.[79]

Section 5 is a particularly problematic piece of this, and sensible limits would go a long way toward mitigating the problem—without removing enforcement authority in the face of real competitive harm, which remains available under the Sherman Act.

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[78] *See* Geoffrey Manne, *The Final Order in the FTC's Google SEP Case and the Continuing Danger to Standard-Setting*, TRUTH ON THE MARKET (Jul. 31, 2013), http://truthonthemarket.com/2013/07/31/the-final-order-in-the-ftcs-google-standard-essential-patents-case-and-the-continuing-danger-to-standard-setting/.

[79] Katy Oglethorpe, *Nokia counsel: major companies "willfully infringe" FRAND,* GLOBAL COMPETITION REVIEW (Jun. 17, 2013), http://globalcompetitionreview.com/news/article/33655/nokia-counsel-major-companies-wilfully-infringe-frand/.

Meanwhile, as noted above, whatever the propriety of the application of Section 5 to these issues, there remains important questions regarding the appropriateness of competition-policy enforcement in this realm at all.

In the first place, the upshot of the FTC's range of actions against patents is, in varying degrees, to move the property rule of patents (enforceable by injunction) more towards a liability rule (enforceable by royalty payments). While the aim is the weakening of patent rights under the theory that doing so will promote innovation and welfare, this assumption, although widely repeated, is by no means established.[80]

Among other things, to the extent that the FTC's SEP actions are motivated by concerns about hold-up problems arising from refusals to license essential IP, it is not evident that the FTC is sufficiently sensitive to the analogous "holdout" problem of potential licensees taking advantage of lax enforcement in order to infringe — an effect that would manifestly lower, not raise, incentives for innovation.[81]

Fundamentally, there remain important questions regarding the benefits for consumer welfare from antitrust interference in IP markets in general. Neither the FTC, nor the academy in general, has resolved these questions, but nevertheless their conduct suggests they have. But as Dan Spulber discusses in a recent, important article:

> [A]ntitrust policy and IP protections are complements in promoting innovation. With effective IP protections, policies that favor competition including antitrust and deregulation can help to speed innovation. But, absent effective IP protections, antitrust policy may actually be harmful because it would diminish incentives to innovate. Applying antitrust policy to weaken appropriability of IP thus would be counter productive. There is some disagreement among economists, legal scholars, and the courts on whether antitrust and IP policies should be viewed as being consistent or in conflict. The present analysis suggests instead that antitrust policy and IP protections should be consistent in encouraging innovation and competition.[82]

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[80] *See, e.g.*, F. Scott Kieff, *IP Transactions: On the Theory & Practice of Commercializing Innovation*, 42 HOUSTON L. REV. 727 (2005).

[81] *See, e.g.*, Manne, Comments on Google Settlement, *supra* note 78.

[82] Spulber, *Competitive Pressures*, *supra* note 68, at 1009.

Consumer Protection

Consumer protection law, unlike antitrust law, has increasingly been shaped primarily by the FTC's discretion, not evolution through judicial review or dialogue with economic scholarship. In the last decade, the FTC has increasingly been using its unfairness authority to address cutting-edge issues. It has even begun pushing the legal boundaries of its authority over deception by extending it beyond traditional advertising claims to online FAQs and the like.

At the heart of the discretionary model is the FTC's ability to operate without any real constraints. The Commission hasn't developed a predictable set of legal doctrines because that's what courts do — and the FTC has managed to strong-arm dozens of companies into settling out of court. What the FTC calls its "common law of consent decrees" is really just a series of unadjudicated assertions. That approach is just as top-down and technocratic as the FCC's regulatory model, but with little due process and none of the constraints of detailed authorizing legislation.

The FTC might be right in any particular case, but overall, what evolves isn't "law." It's merely a list of assertions as to what the Commission thinks companies should and shouldn't do. Unfortunately current and recent FTC leadership has shown little interest in limiting the agency's discretion. In a similar context Commissioner Ohlhausen has pointedly noted:

> The guidance in the Policy Statement will be replaced by this view: "[T]he Commission withdraws the Policy Statement and will rely instead upon existing law, which provides sufficient guidance on the use of monetary equitable remedies." This position could be used to justify a decision to refrain from issuing any guidance whatsoever about how this agency will interpret and exercise its statutory authority on any issue.[83]

UDAP: The *Apple* Case

The FTC's recent complaint and consent agreement with Apple highlights these issues, and, again, Commissioner Wright's scathing dissent ably identifies where and how the agency deviated from sensible economic reasoning.

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[83] Statement of Commissioner Maureen K. Ohlhausen Dissenting from the Commission's Decision to Withdraw its Policy Statement on Monetary Equitable Remedies in Competition Cases (Jul. 31, 2012), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/statement-commissioner-maureen-k.ohlhausen/120731ohlhausenstatement.pdf.

The Commission's unfairness authority under Section 5 of the FTC Act is circumscribed by subsection (n), which itself tracks language issued by the FTC in its 1980 Unfairness Policy Statement. Section 45(n) actually incorporates sensible economic limiting principles:

> The Commission shall have no authority under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair **unless the act or practice causes or is likely to cause substantial injury to consumers** which is **not reasonably avoidable by consumers themselves** and **not outweighed by countervailing benefits to consumers or to competition**.[84] [Emphasis added].

The core requirements (that injury be substantial, that it not be reasonably avoidable by consumers and that it not be outweighed by countervailing benefits) serve to enshrine an error cost approach to unfairness questions, limiting both the likelihood and harm of erroneous over-enforcement.

One of the key reasons for performing a cost-benefit analysis as required by the FTC's Policy Statement (and subsequently codified in Section 5) is to ensure that government action does more good than harm. As Commissioner Wright succinctly puts it in his *Apple* dissent:

> To justify a finding of unfairness, the Commission must demonstrate the allegedly unlawful conduct results in net consumer injury.[85]

That such a balancing was absent from the majority's decision in *Apple* reflects not only dereliction of a legal obligation by the Commission, but also the subversion of sensible economic analysis. As Wright notes:

> The Commission, under the rubric of "unfair acts and practices," substitutes its own judgment for a private firm's decisions as to how to design its product to satisfy as many users as possible, and requires a company to revamp an otherwise indisputably legitimate business practice. Given the apparent benefits to some consumers and to competition from Apple's allegedly unfair practices, I believe the Commission should have conducted a

[84] 15 U.S.C. §45, http://www.law.cornell.edu/uscode/text/15/45.

[85] Dissenting Statement of Commissioner Joshua D. Wright, In the Matter of Apple, Inc., FTC File No. 1123108, at 14 (Jan. 15, 2014), *available at* http://www.ftc.gov/sites/default/files/documents/cases/140115applestatementwright_0.pdf [hereinafter "Wright *Apple* Dissent"].

> much more robust analysis to determine whether the injury to this small group of consumers justifies the finding of unfairness and the imposition of a remedy.[86]

Undertaking an appropriate cost-benefit analysis — as the Commission's own Policy Statement requires — would have yielded a different result given available facts:

> In particular, although Apple's allegedly unfair act or practice has harmed some consumers, I do not believe the Commission has demonstrated the injury is substantial. More importantly, any injury to consumers flowing from Apple's choice of disclosure and billing practices is outweighed considerably by the benefits to competition and to consumers that flow from the same practice.[87]

What's particularly notable about the *Apple* case - and presumably will be in future technology enforcement actions predicated on unfairness - is the unique relevance of the attributes of the conduct at issue to its product. Unlike past, allegedly similar cases, Apple's conduct was not aimed at deceiving consumers, and nor was it incidental to its product offering. Instead, as Wright notes:

> [R]ather than an unscrupulous or questionable practice, the nature of Apple's disclosures on its platform is an important attribute of Apple's platform that affects the demand for and consumer benefits derived from Apple devices and services. Disclosures made on the screen while consumers interact with mobile devices are a fundamental part of the user experience for products like mobile computing devices. It is well known that Apple invests considerable resources in its product design and functionality. In streamlining disclosures on its platform and in its choice to integrate the fifteen-minute window into Apple users' experience on the platform, Apple

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[86] *Id*. at 1-2. While Commissioner Wright's dissent is remarkable for demanding a new level of analytical rigor in a consumer protection case, it is neither novel nor aberrant in the larger context of the FTC's work. In fact, the kind of law and economics Wright proposes should be applied in weighing unfairness has long been applied in antitrust cases. And the substantive position that analysis leads him to dovetails with the prevailing *per se* rule in antitrust law that there is no liability for "predatory" innovation or product design. *See, e.g.*, Allied Orthopedic v. Tyco, 592 F.3d 991 (9th Cir. 2010). Even the standard in *Microsoft*, which the court in *Tyco* rejected, required a balancing of costs and benefits and, ultimately, proof by the plaintiff that the harm to consumers outweighed the defendant's justifications for its design decisions. *Cf.* U.S. v. Microsoft Corp., 253 F.3d 34 (D.C. Cir. 2001).

[87] Wright *Apple* Dissent, *supra* note 85, at 2.

> has apparently determined that most consumers do not want to experience excessive disclosures or to be inconvenienced by having to enter their passwords every time they make a purchase.[88]

But by challenging the practice, particularly without the balancing of harms required by Section 5, the FTC majority substituted its own judgment not about some manifestly despicable conduct but about the very design of Apple's products. This is the sort of area where regulatory humility is more — not less — important:

> With complex technology products such as computing platforms, firms generally find and address numerous problems as experience is gained with the product. Virtually all software evolves this way, for example. This tradeoff— between time spent perfecting a platform up front versus solving problems as they arise—is also relevant for evaluating unfairness.
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> * * *
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> Nonetheless, the Commission effectively rejects an analysis of tradeoffs between the benefits of additional guidance and potential harm to some consumers or to competition from mandating guidance by assuming that "the burden, if any, to users who have never had unauthorized charges for in-app purchases, or to Apple, from the provision of this additional information is de minimis" and that any mandated disclosure would not "detract in any material way from a streamlined and seamless user experience." I respectfully disagree. These assumptions adopt too cramped a view of consumer benefits under the Unfairness Statement and, without more rigorous analysis to justify their application, are insufficient to establish the Commission's burden.[89]

Again, regulatory self-restraint is even more needed with complex, technologically advanced products of the sort the Commission is increasingly asked to assess, and the FTC's Unfairness Statement itself requires the Commission to "consider the impact of contemplated remedies or changes in the incentives to innovate new product features upon consumers and competition."[90] In failing to observe such limits in *Apple*, the FTC set a dangerous precedent that, given the agency's enormous regulatory scope, could cause

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[88] *Id*. at 4.

[89] *Id*. at 11-12, 13.

[90] *Id*. at 15 (*citing* Unfairness Statement at 1073-74).

significant harm to consumers. As Wright concludes:

> Establishing that it is "unfair" unless a firm anticipates and fixes such problems in advance – precisely what the Commission's complaint and consent order establishes today – is likely to impose significant costs in the context of complicated products with countless product attributes. These costs will be passed on to consumers and threaten consumer harm that is likely to dwarf the magnitude of consumer injury contemplated by the complaint.[91]

UDAP: Data Security Cases

Through a string of more than 50 UDAP enforcement actions over the last decade, the FTC has policed how American companies protect user data. Initially, the Commission used this standard only in deception cases, reading in an implied promise of reasonableness into data security promises and holding companies responsible if actual practice was found to be unreasonable. Since 2005, however, the FTC has expanded the reasonableness approach to cases in which the company made no security promise, essentially collapsing UAP's substantial injury/countervailing benefit/reasonably avoidable elements into "reasonableness," which in turn has largely, if not explicitly, been defined by the data security standards (the "Safeguards Rule") promulgated through APA rulemaking for financial institutions under Gramm-Leach-Bliley.[92]

In principle, it makes sense treat some forms of inadequate data security as an unfair trade practice, regardless of whether the company made any promise about security. But recent experience suggests the FTC is moving toward *ex post* strict liability and away from judging the reasonableness of security precautions *ex ante* on sensible economic grounds, and making that assessment without first developing or explaining the elements of unfairness in a rigorous way. While companies, such as Wyndham, and many commentators have argued for the need for greater guidance,[93] it is not clear what shape that guidance should take.

Although some have argued that the agency's data security complaints, consent orders,

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[91] *Id*. at 16.

[92] 16 CFR §314.

[93] *See* Amici Curiae Brief of TechFreedom, International Center for Law and Economics & Consumer Protection Scholars, FTC v. Wyndham Worldwide Corp., No. 2:13-cv-01887 (D.N.J. Jun. 17, 2013), *available at* http://docs.techfreedom.org/Wyndham_Amici_Brief.pdf [hereinafter "Wyndham Amicus Brief"].

speeches and Congressional testimony collectively provide sufficient guidance, the lack of more formal guidelines is notable.[94] Moreover, this set of guiding materials is notably lacking any direct discussion of the reasons data security investigations are closed (and none are likely to appear in the near future given a relatively new, informal policy strongly disfavoring such explanations).[95]

To the extent that the FTC's approach has, in fact, become a "strict liability" rule, presuming that any loss of data is *per se* proof that a company's data security practices were unreasonable, there is no evidence that the inherent trade-offs this entails between increased administrability and economic rigor, or between preventing consumer injury and imposing costs on businesses that are ultimately born by consumers, is actually desirable. Again, *how* the FTC weighs those trade-offs may be as important as the substantive conclusion of that process.

In practice, the FTC brings data security cases (under both Deception and Unfairness) based on the alleged unreasonableness of a respondent's security practices without addressing the actual Section 5 elements (materiality, substantial injury, etc.) and without connecting them to reasonableness. As Commissioner Wright discussed in his *Apple* dissent, the FTC's failure to apply Section 45(n)'s doctrinal limitations to the particular facts of a case is cause for concern, particularly in the rapidly innovating world of data security.

Furthermore, failing to apply Section 45(n)'s three prongs in any meaningful way (let alone a rigorous manner) discounts the need for experimentation by companies that may become caught in the FTC's *per se* trap. It deters self-correction and consumer self-help and fails to weigh the costs and benefits of particular data security practices with reference to other characteristics (like company size, industry, threat, etc.).

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[94] Some have further argued, in fact, that that the threat of action through speeches, reports and the like is preferable to more concrete statements or guidelines because they are even more flexible. *See, e.g.*, Tim Wu, *Agency Threats*, 60 DUKE L.J. 1841 (2011), *available at* http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1506&context=dlj.

[95] The FTC has issued very few closing letters on data security issues. None of them is particularly helpful. *See* FTC FOIA Request Response <on file with author>. Some of the letters are completely devoid of useful information. *See, e.g.*, Michaels Closing Letter (Jul. 26, 2012), *available at* http://www.ftc.gov/sites/default/files/documents/closing_letters/michaels-stores-inc./120706michaelsstorescltr.pdf. To the best of our knowledge, this was only "closing letter" regarding data security since 2009. That letter provides no details on the nature of the investigation or the reasons why it was closed. At the same time, some of the letters do, if briefly, lay out the FTC's basic reasoning, providing somewhat more helpful guidance. *See, e.g.,* Dollar Tree Letter Closing Letter (Jun. 5, 2007), *available at* http://www.ftc.gov/sites/default/files/documents/closing_letters/dollar-tree-stores-inc./070605doltree.pdf.

At the same time, greater *ex ante* certainty (say, in the form of data security principles or a formal rulemaking) could end up sacrificing too much flexibility, possibly imposing even greater costs (of a different sort) on businesses and consumers than the current regime. Care must be taken in drafting any sort of guidance to ensure that it doesn't enshrine a particular data security regime (much as the FTC's current reliance on the Safeguards Rule has essentially done). But such guidance could, among other things:

- **Define the appropriate boundaries of substantial injury**. Current FTC cases often rely on losses borne by companies (fraudulent charges reimbursed to consumers), rather than by consumers directly. In doing so, the FTC may in fact be protecting large businesses rather than consumers. Consumers can, and do, suffer out of pocket losses, particularly with new account fraud, but it is unclear how great they must be to constitute substantial injury. Businesses, in general, are capable of protecting themselves against injury. For example, credit card companies include data security requirements in their contracts with merchants. If they do not require more or do not enforce these requirements more aggressively, yet bear the economic consequences of inadequate data security (as is the case with credit card number theft) basic economic logic would suggest that it is because the credit card companies believe that they have struck the optimal balance between costs and benefits. There is little reason to think the FTC knows better.
- **Determine the appropriate treatment of mitigation costs**. It is unclear whether the time and effort required by consumers to mitigate harm, such as by monitoring account charges or replacing credit cards should constitute cognizable harm. Doctrinally, it is unclear whether this should be measured as a form of injury or as part of the inquiry into whether consumers can "reasonably avoid" injury. Logically, if *any* mitigation costs were considered "substantial" injury, the "reasonably avoidable" prong of unfairness would be meaningless, and "injury" would probably be stretched far beyond the boundary of substantiality.
- **Consider the appropriate extent of specificity**. The current *de facto* guidance provided in the Safeguards Rule, while offering some details, nonetheless ultimately rests on operative standards like "reasonable" and "effective." The agency has not, as far as I know, carefully considered whether this is the appropriate amount of specificity and guidance necessary since the Safeguards Rule itself was adopted; certainly this is the case with respect to the appropriate amount of specificity in data security and other fast-paced issues.
- **Explain reasonable foreseeability**. As the FTC expands its data security enforcement efforts into increasingly novel situations, the key question increasingly becomes whether a specific risk was reasonably foreseeable. In at least one closing letter, the FTC explained that the risk of a particular technique for stealing debit card information at cash registers was not reasonably foreseeable, given its

sophistication.[96] Yet in recent years the FTC has, among other things, alleged that a small cancer treatment lab should have foreseen the risks posed by peer-to-peer file-sharing software as a potential source of data leakage and taken even more steps than it did to keep such software off its machines[97] – long before the FTC itself issued any formal guidance on such matters[98] and years before the FTC brought an enforcement action against the makers of such software for designing it in such a way as to trick users into over-sharing information.[99] Doctrinally, this question speaks to what the defendants in *Wyndham* have argued is actually the fourth prong of unfairness: causation.[100]

- **Determine the role of specific company characteristics in deciding outcomes**. It is unclear (in large part because the extent of publicly available analysis is so minimal) whether reasonableness depends, under the Safeguards Rule, on the specific characteristics of the company. To the extent that it does, the mechanism is opaque. A well-considered policy statement could identify whether and how particular businesses might avoid inefficient implementation of the FTC's data security standards based on particular company characteristics. Similarly, more rigorous guidance could better ensure that the duty of care imposed on businesses is appropriate to their size and degree of sophistication, as well as to the security threats at issue.

Process Issues

Consent Decrees

In some areas of law, most notably privacy, data security, and high-tech product design, the FTC operates almost entirely by settling enforcement actions in consent decrees. Consent decrees, generally with 20-year terms, are also increasingly becoming a tool for

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[96] *See* Dollar Tree Closing Letter, *supra* note 95.

[97] In the Matter of LabMD, Docket No. 9357, *available at* http://www.ftc.gov/enforcement/cases-proceedings/102-3099/labmd-inc-matter.

[98] FEDERAL TRADE COMMISSION, PEER-TO-PEER FILING SHARING: A GUIDE FOR BUSINESS (2010), *available at* http://www.business.ftc.gov/documents/bus46-peer-peer-file-sharing-guide-business.

[99] In the Matter of Frostwire and Angel Leon, No. 111-cv-23643, *available at* http://www.ftc.gov/enforcement/cases-proceedings/112-3041/frostwire-llc-angel-leon.

[100] Section 45(n) provides that "[t]he Commission shall have no authority … to declare … an act or practice … unfair unless the act or practice **causes or is likely to cause** substantial injury to consumers…."

informal policymaking, allowing the Commission to require individual companies to agree to things that are not required by law and thus might more appropriately be addressed on a general basis through the FTC's essentially forgotten Magnuson-Moss rulemaking process. This is particularly true in the high-tech sector and on issues such as privacy. With nearly every major large technology company operating under a consent decree, many have asked whether the FTC is moving towards a form of regulation in which its discretion will be even less constrained, as companies face additional pressure to settle alleged violations of consent decrees because they face monetary penalties (unavailable in Section 5 cases) and even worse public relations fallout than for violations of Section 5.

It is unclear what limits (if any) exist on the FTC's discretion in setting the terms of consent decrees and thus on its ability to make policy via consent decree, such as by requiring "privacy by design" or "security by design" or, in the case of Apple, "industrial design by the FTC's design."

Because the standards for determining whether a company has violated a consent decree differ from those required to establish a Section 5 violation, and because the legal standard is much lower, the FTC may be using consent decrees, unmoored from the requirements of Section 5 or its own Unfairness and Deception Policy Statements, to circumvent the constraints established by its own Policy Statements and by Congress.

Moreover, bringing these companies under consent decrees, and then treating future conduct as a violation of those decrees even when not clearly related, allows the FTC to invent the very power Congress has refused to give it: a blanket authority to issue civil penalties. In general, the FTC may not impose penalties for first-time violations of Section 5, only for violations of consent decrees. In 2010, the FTC lobbied aggressively for general civil penalty authority as part of the financial regulatory overhaul, but was rebuffed by Congress – and for good reason: the looming threat of monetary penalties would significantly discourage companies from innovating in areas where technology may unsettle user expectations, and further aggravate the problem of companies tending to settle FTC complaints, rather than litigate. The result would be both a decline in innovation, thus harming consumers; a freer hand for the FTC in pushing the boundaries of consumer protection law beyond what Congress intended; and even less guidance as to the boundaries of the FTC's so-called common law of consumer protection.

There are further problems. In cases where the agency does act, the FTC's complaints describe numerous potential problems but offer few insights into which ones were particularly important to the FTC's decision to bring an enforcement action. For example, the FTC's apparent desire to avoid suggesting that any one step is the key to information security has trumped the need for guidance to the regulated community about what is important and what is not required. Such lack of guidance could well violate judicial requirements that agencies must, to satisfy constitutional standards of due process, provide "fair notice" of their policies, although that judicial doctrine may be underdeveloped.[101]

In many instances consent agreements are efficient and effective: No one is saying that the FTC should have to litigate every case, most cases or even very many cases. But there is a world of difference between having very nearly *no* litigated cases and having *some*. Given the reality that companies are reluctant to litigate, the obvious place to begin addressing the guidance problem is with the complaints and consent agreements themselves. For example, the FTC could explain more of its legal analysis in its complaints. In an amicus brief in the *Wyndham* case, Gus Hurwitz, Paul Rubin, Berin Szoka, Todd Zywicki and I have argued that the FTC's unfairness complaint in that case (and in data security cases more generally) may not satisfy even the minimum pleading requirements laid out in *Twombly* and *Iqbal*; further, the FTC fails to fulfill the particularity requirements Federal Rule of Civil Procedure 9(b), governing cases that "sound in fraud" (which would seem to, and ought to, include deception).[102] In addition, the FTC could issue competitive impact statements with each settlement, including a fuller discussion of the agency's reasoning, the importance of particular facts and legal arguments, and clarification of general principles.

The problem of the excessive use of consent decrees at the agency is exacerbated by its administrative procedures, which create a fundamental imbalance between the agency and the businesses it regulates. As Commissioner Wright noted in his speech introducing his UMC Statement:

> The uncertainty surrounding the scope of Section 5 is exacerbated by the administrative procedures available to the Commission for litigating unfair methods claims. This combination gives the Commission the ability to, in some cases, take advantage of the uncertainty surrounding Section 5 by challenging conduct as an unfair method of competition and eliciting a settlement even though the conduct in question very likely would not violate the traditional federal antitrust laws. This is because firms typically will prefer to settle a Section 5 claim rather than going through lengthy and costly administrative litigation in which they are both shooting at a moving target and have the chips stacked against them. Such settlements only perpetuate the uncertainty that exists as a result of ambiguity associated

[101] *See* Wyndham Amicus Brief, *supra* note 93, at 6-12.

[102] *See id.* at 12-20.

> with the Commission's Section 5 authority by encouraging a process by which the contours of the Commission's unfair methods of competition authority are drawn without any meaningful adversarial proceeding or substantive analysis of the Commission's authority.[103]

Or as Commissioner Wright highlighted in his dissent in *Nielsen/Arbitron*:

> Whether parties to a transaction are willing to enter into a consent agreement will often have little to do with whether the agreed upon remedy actually promotes consumer welfare. The Commission's ability to obtain concessions instead reflects the weighing by the parties of the private costs and private benefits of delaying the transaction and potentially litigating the merger against the private costs and private benefits of acquiescing to the proposed terms.... Put simply, where there is no reason to believe a transaction violates the antitrust laws, a sincerely held view that a consent decree will improve upon the post-merger competitive outcome or have other beneficial effects does not justify imposing those conditions. Instead, entering into such agreements subtly, and in my view harmfully, shifts the Commission's mission from that of antitrust enforcer to a much broader mandate of "fixing" a variety of perceived economic welfare-reducing arrangements.
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> Consents can and do play an important and productive role in the Commission's competition enforcement mission.... However, consents potentially also can have a detrimental impact upon consumers. The Commission's consents serve as important guidance and inform practitioners and the business community about how the agency is likely to view and remedy certain mergers. Where the Commission has endorsed by way of consent a willingness to challenge transactions where it might not be able to meet its burden of proving harm to competition, and which therefore at best are competitively innocuous, the Commission's actions may alter private parties' behavior in a manner that does not enhance consumer welfare. Because there is no judicial approval of Commission settlements, it is especially important that the Commission take care to ensure its consents are in the public interest.[104]

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[103] Wright, *Section 5 Recast*, *supra* note 42, at 10.

[104] Wright, *Nielsen* Dissent, *supra* note 16, at 6-7.

The pseudo-common law of un-adjudicated settlements, lacking any doctrinal analysis that the FTC has developed under its unfairness authority, simply doesn't provide sufficient grounds to separate the fair from the unfair.[105]

Perhaps most significantly in this regard, the FTC's so-called "common law" decisions identify, at best, only what conduct in specific instances *violates* the law; they do not identify what conduct does *not* violate the law. Real common law, by contrast, provides insights into both – offering guidance to firms regarding not only specifically proscribed conduct but also the scope of conduct in which they may operate without fear of liability. Consent decrees tell us, for example, that "invitations to collude" and "deception in standard setting" are violations of Section 5. And thus they are potentially useful guidance for that conduct. But they tell us very little to nothing about the *next* type of conduct that will be prosecuted under Section 5.

Instead, the FTC's current approach to its unfairness enforcement denies companies "a reasonable opportunity to know what is prohibited" and thus to follow the law. The FTC has previously suggested that its settlements and Congressional testimony offer all the guidance a company would need, as when Chairwoman Ramirez claimed that:

> Section 5 of the FTC Act has been developed over time, case-by-case, in the manner of common law. These precedents provide the Commission and the business community with important guidance regarding the appropriate scope and use of the FTC's Section 5 authority.[106]

But settlements (and testimony summarizing them) do not in any way constrain the FTC's subsequent enforcement decisions. They cannot alone be the basis by which the FTC provides guidance on its UMC authority because, unlike published guidelines, they do not purport to lay out general enforcement principles and are not recognized as doing so by courts and the business community. It is impossible to imagine a court faulting the FTC for failure to adhere to a previous settlement, particularly because settlements are not readily

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[105] *See* Wyndham Amicus Brief, *supra* note 93, at 6-7.

[106] Ramirez Questions for the Record, *Hearing before the S. Comm. on the Jud. Subcomm. on Antitrust, Competition Pol'y and Consumer Rights: "Oversight of the Enforcement of the Antitrust Laws"* (Apr. 16, 2013), *available at* http://www.judiciary.senate.gov/resources/documents/113thCongressDocuments/upload/041613QFRs-Ramirez.pdf. *See also Hearing before S. Comm. on the Jud. Subcomm. on Antitrust, Competition Pol'y and Consumer Rights: Standard Essential Patent Disputes and Antitrust Law* (statement of Federal Trade Commission, Jul. 30, 2013), *available at* http://www.judiciary.senate.gov/pdf/7-30-13MunckTestimony.pdf.

generalizable and bind only the parties who agree to them.[107] As we put it in our *Wyndham* amicus brief:

> Even setting aside this basic legal principle, the gradual accretion of these unadjudicated settlements does not solve the vagueness problem: Where guidelines provide cumulative analysis of previous enforcement decisions to establish general principles, these settlements are devoid of doctrinal analysis and offer little more than an infinite *regress* of unadjudicated assertions.[108]

Rulemaking is generally preferable to case-by-case adjudication as a way to develop agency-enforced law because rulemaking both reduces vagueness and constrains the mischief that unconstrained agency actions may cause. As the Supreme Court noted in *SEC v. Chenery Corp.*:

> The function of filling in the interstices of [a statute] should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future.[109]

Without Article III court decisions developing binding legal principles, and with no other meaningful form of guidance from the FTC, the law will remain vague – perhaps even unconstitutionally so.[110] And the FTC's approach to enforcement also allows the FTC to act both arbitrarily and discriminatorily—backed by the costly threat of the CID process and Part III adjudication. This means a company faces two practically certain defeats—before the administrative law judge and then the full Commission, each a public relations disaster.

Reports & Workshops as Informal Rulemakings

Information-gathering is essential both to inform the FTC's law enforcement efforts and as an end unto itself, to inform the larger policy debates about important issues at the agency, including notably privacy and data security. The FTC has held a series of

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[107] *See, e.g.*, Altria Group, Inc. v. Good, 555 U.S. 70, 89 n.13 (2008) (noting a FTC "consent order is… only binding on the parties to the agreement").

[108] Wyndham Amicus Brief, *supra* note 93, at 8-9.

[109] SEC v. Chenery Corp., 332 U.S. 194 (1947), *available at* http://supreme.justia.com/cases/federal/us/332/194/case.html.

[110] *See* Wyndham Amicus Brief, *supra* note 93, at 6-12.

workshops and issued a string of reports since 1996.[111] Together, these provide an invaluable narrative of the history of consumer privacy in the U.S.

But the purpose of the reports has clearly shifted, from descriptive to prescriptive. Now, rather than describe the state of the art or issues raised by technological change, or even summarizing FTC enforcement actions, the agency's reports routinely assert what companies "should" do, setting best practices that the agency turns into more than mere recommendations. These "recommendations," most recently, for "privacy by design" and "security by design," are not technically legally binding. But the FTC has pushed companies to adopt them through a combination of public pressure from the Commission's large bully pulpit, treating them as unofficial legal standards in enforcement actions, requiring companies to agree to them when settling enforcement actions, and heavily pushing their incorporation into multistakeholder standard-setting processes.

In short, the workshop-and-report process has become a functional part of the FTC's extra-legal formulation of "soft law" that is not clearly grounded in the agency's Section 5 legal authority or in any systematic or rigorous economic analysis. Indeed, this process has effectively allowed the FTC to circumvent the procedural safeguards imposed by Congress in the special Magnuson-Moss rulemaking authority for Section 5.

The Role of the Bureau of Economics

Implementing more and better economic analysis at the FTC should begin with a consideration of how the agency can make better use of the considerable economic expertise in its Bureau of Economics (BE). The FTC is an unusual agency in that it has a large staff of economists; it should leverage that capacity to guide all of its work. That means the FTC should better employ its economics expertise in a meaningful way in consumer protection issues.

Relatedly, cost-benefit analysis of the sort regularly employed by BE should be more widely practiced by the Commissioners in their decision-making and policy analysis. For example, ongoing privacy discussions have been largely devoid of any rigorous cost-benefit analysis. This should be rectified, and institutional reforms put in place to ensure that cost-benefit analysis is both rigorous and a meaningful check on agency discretion.

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[111] *See* Federal Trade Commission, *Protecting Consumer Privacy in an Era of Rapid Change: Recommendations for Businesses and Policymakers* at B-1 (Mar. 2012), *available at* http://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-report-protecting-consumer-privacy-era-rapid-change-recommendations/120326privacyreport.pdf (timeline listing major FTC privacy actions and identifying workshops and reports) [hereinafter FTC Privacy Report]. See also "Legal Resources > Reports and Workshops" http://www.business.ftc.gov/legal-resources/8/34.

The Bureau of Economics has long shaped the Bureau of Competition's implementation of the antitrust laws, both by having a formal role in competition enforcement and by having a leading role in writing the antitrust guidelines co-authored by the FTC and Department of Justice. But what is BE's role in consumer protection matters, and what should it be? Indeed, what is the role of economics as a discipline in limiting the FTC's broad discretion to define UDAP, and in ensuring that the FTC's UDAP efforts do not inadvertently harm competition?

As the FTC increasingly uses its deception authority beyond enforcement of traditional marketing claims to enforce codes of conduct, FAQs, help files and other informal statements, it is testing the presumption of materiality that once helped to ensure that consumers got the benefit of the bargain promised them. Economic analysis, and BE in general, can and should play a significant role in shaping the Commission's emerging, expanded doctrine of materiality.

The Unfairness Policy Statement clearly defines consumer injury as the lodestar of Section 5 and demands cost-benefit analysis by requiring that the FTC weigh injury against countervailing benefits to consumers or to competition. Yet, with scant litigation of unfairness cases (both UAP and UMC), it is not clear that the FTC is engaging in much cost-benefit analysis in practice. The Apple case, discussed above, raises serious concerns in this regard, and it is apparent that the requisite economic analysis was simply absent in the majority's holding in that case, as Commissioner Wright notes in his dissent:

> To support the complaint and consent order the Commission issues today requires evidence sufficient to support a reason to believe that Apple will undersupply guidance about its platform relative to the socially optimal level.... Staff has not conducted a survey or any other analysis that might ascertain the effects of the consent order upon consumers.... The absence of this sort of rigorous analysis is made more troublesome in the context of a platform with countless product attributes and where significant consumer benefits are intuitively obvious and borne out by data available to the Commission.[112]

And on the particularly thorny question of the effect of the FTC's decisions — enforcement and policy-making alike — economic analysis and input from BE should play a significant role in assessing the impact of regulation on innovation.

[112] Wright *Apple* Dissent, *supra* note 85, at 14.

HSR Amendments

Last year, over Commissioner Wright's dissent, the FTC approved amendments to its HSR rules[113] that, as Wright summarizes in his dissent,

> Establish, among other things, a procedure for the automatic withdrawal of an HSR filing upon the submission of a filing to the U.S. Securities and Exchange Commission announcing that the notified transaction has been terminated.[114]

As Commissioner Wright pointed out in his Concurring Statement to the Notice of Public Comment before the rules were adopted:

> The proposed rulemaking appears to be a solution in search of a problem. The Federal Register notice states that the proposed rules are necessary to prevent the FTC and DOJ from "expend[ing] scarce resources on hypothetical transactions." Yet, I have not to date been presented with evidence that any of the over 68,000 transactions notified under the HSR rules have required Commission resources to be allocated to a truly hypothetical transaction. Indeed, it would be surprising to see firms incurring the costs and devoting the time and effort associated with antitrust review in the absence of a good faith intent to proceed with their transaction.
>
> The proposed rules, if adopted, could increase the costs of corporate takeovers and thus distort the market for corporate control. Some companies that had complied with or were attempting to comply with a Second Request, for example, could be forced to restart their antitrust review, leading to significant delays and added expenses. The proposed rules could also create incentives for firms to structure their transactions less efficiently and discourage the use of tender offers. Finally, the proposed new rules will

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[113] Premerger Notification; Reporting and Waiting Period Requirements, 78 Fed. Reg. 41293 (Jul. 10, 2013), *available at* http://ftc.gov/os/fedreg/2013/06/130628hsrfinalrulefrn.pdf.

[114] Dissenting Statement of Commissioner Joshua D. Wright Regarding Amendments to Hart-Scott-Rodino Rules, FTC Matter No. P989316 (Jun. 28, 2013), *available at* http://www.ftc.gov/sites/default/files/documents/public_statements/dissenting-statement-commissioner-joshua-d.wright/130628hsrstmtwright.pdf. For my previous discussion of the proposed amendments and the circumstances surrounding their adoption, see Geoffrey Manne, *Josh Wright Begins Making His Mark at the FTC by Pushing Cost-Benefit Analysis*, TRUTH ON THE MARKET (Feb. 4, 2013), http://truthonthemarket.com/2013/02/04/josh-wright-begins-making-his-mark-at-the-ftc-by-pushing-cost-benefit-analysis/.

> disproportionately burden U.S. public companies; the Federal Register notice acknowledges that the new rules will not apply to tender offers for many non-public and foreign companies.
>
> Given these concerns, I hope that interested parties will avail themselves of the opportunity to submit public comments so that the Commission can make an informed decision at the conclusion of this process.[115]

Unfortunately the amendments were adopted without any evidence whatever to suggest they were needed or would be helpful in any way, thus running roughshod over the basic "principle of good governance that federal agencies should issue new regulations only if their benefits exceed their costs."[116]

As it happens, the single comment received by the Commission on the proposed rule supported Wright's views:

> Although the rule may prevent such inefficiency in the future, it would also require companies to incur substantial costs in premerger negotiations and resource allocation while waiting for FTC approval during the HSR period. Currently, firms can avoid such costs by temporarily withdrawing offers or agreements until they are assured of FTC approval. Under the proposed rule, however, doing so would automatically withdraw a company's HSR filing, subjecting it to another HSR filing and filing fee.[117]

It must be counted a straightforward abdication of sensible principles of economic analysis and good governance that these amendments were adopted without any evidence to support them.

Economic analysis at the FTC should not be confined only to competition policy nor only to substantive decision-making. Instead, it can and should govern the full range of the Commission's decisions. Consumers may be harmed just as much by faulty process as by bad substantive decision-making. As Commissioner Wright recently noted:

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[115] Wright Concurrence in Notice of Public Comment for Proposed HSR Rules, http://www.ftc.gov/os/2013/02/130201hsrnprm-jwrightstmt.pdf.

[116] Dissenting Statement of Commissioner Joshua D. Wright Regarding Amendments to Hart-Scott-Rodino Rules, *supra* note 114, at 1.

[117] Comment of Kenneth Hsu on Comments on proposed amendments to the premerger notification rules, at 1, *available at* http://www.ftc.gov/sites/default/files/documents/public_comments/2013/03/564158-00002-85843.pdf.

> When people think about the role that economics plays in antitrust, the first thing they think of is economic analysis aimed at identifying the competitive effects of some business transaction or conduct. I do not think my background in economics necessarily distinguishes what I do from the way others approach problems when evaluating a transaction or conduct, because everybody relies upon economics when approaching those problems—the economics is part of the law.
>
> The bigger difference, in my view, is that economics provides a framework to organize the way I think about issues beyond analyzing the competitive effects in a particular case, including, for example, rulemaking, the various policy issues facing the Commission, and how I weigh evidence relative to the burdens of proof and production. Almost all the decisions I make as a Commissioner are made through the lens of economics and marginal analysis because that is the way I have been taught to think.[118]

Suggestions for Reform

Instead of asserting what companies should do, the FTC needs to offer more guidance on what it thinks its legal authority means – which is ultimately a matter of economic analysis. And the Commission can't just ignore or revoke those limiting principles when they become inconvenient. A more significant and better-defined role for economics, and thus the agency's Bureau of Economics, could provide some degree of internal constraint. That's a second-best to the external constraint the courts are supposed to provide. But it could at least raise the cost of undertaking enforcement actions simply because three Commissioners — or a few staff lawyers — think they're helping consumers by crucifying a particular company.

One easy place to start would be holding a comprehensive workshop on data security and then issuing guidelines – not merely recommendations, but actual analyses of the FTC’s legal authority and the way it has been applied in past cases, *i.e.*, something more akin to the antitrust guidelines than the FTC’s various hortatory reports. The FTC has settled more than 50 data security cases but has provided scant guidance, even though data breaches and the identity thefts they cause are far and away the top subject of consumer complaints. The goal wouldn't be to prescribe what, specifically, companies should do but how they should understand their evolving legal duty. For example, at what point does an industry

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[118] Interview with Joshua Wright, *supra* note 26.

practice become sufficiently widespread to constitute "reasonable" data security, or when does a particular threat become reasonably foreseeable?

More ambitiously, the FTC could use its unique power to enforce voluntary commitments to kick start new paradigms of regulation. That could include codes of conduct developed by industry or multistakeholder groups as well as novel, data-driven alternative models of self-regulation. For example, Uber, Lyft and other app-based personal transportation services could create a self-regulatory program based on actual, real-time data about safety and customer satisfaction. The FTC could enforce such a model — if Congress finally makes common carriers subject to the FTC Act. The same could work for online education, Airbnb and countless other disruptive alternatives to traditional industries and the regulators they've captured.

Finally, the FTC could do more of what it does best: competition advocacy — like trying to remove anticompetitive local government obstacles to broadband deployment. The FTC has earned praise for defending Uber from regulatory barriers taxicab commissions want to protect incumbents. That's the kind of thing a Federal Technology Commission ought to do: stand up for new technology, instead of trying to make "it turn out according to plan."